In The

Supreme Court of the United States

October Term 1978

No. 77-1413

Jane Aronson,

Petitioner,

v.

Quick Point Pencil Company,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF ON BEHALF OF THE PATENT, TRADEMARK AND COPYRIGHT SECTION OF THE STATE BAR OF TEXAS AS AMICUS CURIAE

Ned L. Conley
Butler, Binion, Rice, Cook & Knapp
1100 Esperson Building
Houston, Texas 77002

Attorneys for Amicus Curiae The Patent, Trademark and Copyright Section of the State Bar of Texas

FIDELITY PRINTING COMPANY, HOUSTON

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM 1978

No. 77-1413

JANE ARONSON,

Petitioner,

v.

QUICK POINT PENCIL COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF ON BEHALF OF THE PATENT, TRADEMARK AND COPYRIGHT SECTION OF THE STATE BAR OF TEXAS AS AMICUS CURIAE

I.

THE NATURE OF THE AMICUS

This brief amicus curiae is submitted by the Patent, Trademark and Copyright Section of the State Bar of Texas under Rule 42(2) of this Court.

The Patent, Trademark and Copyright Section of the State Bar of Texas (the "Section") consists of approximately 275 Texas lawyers whose practice is predominantly or entirely in the intellectual property field, and virtually all

of whom deal with the problems of licensing patents, know-how and trade secrets. Nearly all of the lawyers in Texas who practice predominantly in the intellectual property field are members of the Section. The practice of these lawyers includes preparation and negotiation of patent licenses, know-how transfers and trade secret licenses and assignments, as well as representation of either side in disputes arising out of such agreements. Some members of the Section are sole practitioners, some are members of small to quite large law firms, and some are house counsel for medium to large corporations. Clients represented by the members of the Section include individuals, small businesses and large corporations.

Because of the nature of their practice, the members of the Section have become knowledgeable concerning the business and economic realities of dealing with the transfer of intellectual property.

II.

THE INTEREST OF THE AMICUS

The Amicus has no interest in the outcome of this case, but does have a great interest in the continuing viability of state laws under which parties may contract with respect to rights to intellectual property, so long as there is no conflict with the patent laws or the federal antitrust law. The Amicus is concerned with the maintenance of perhaps thousands of commercial transactions entered into in good faith by parties who knew the benefits and costs involved, and bargained for what they received, with the expectation by all concerned that royalties provided for by the agreements would be paid in accordance with the agreed-upon terms.

The Question presented is much broader than necessary for determination of the correctness of the decision of the

Court of Appeals under the circumstances of this particular case. Instead, the Court should consider only the narrow issue raised by the decision of the Court of Appeals. That, of course, is the primary function of this Court. See *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

The Court of Appeals clearly limited *its* decision to the facts which the Court found to exist in the case before it, i.e.:

1) There was a written contract;
2) A patent application had been filed on the discovery;
3) The contract specifically provided that royalties would be paid, albeit at a reduced rate, even if no patent issued;
4) The contract was not for disclosure of the idea, but for the exclusive right to manufacture[1];
5) The discovery was completely disclosed by the marketing of the goods; and
6) The prospective patent protection was not used to coerce an agreement to pay a royalty if no patent was granted.[2]

This Court's consideration of the Question should likewise be focused on this fact situation. An affirmative answer to the Question as broadly as stated would have far-reaching implications that cannot now be fully anticipated, although it would certainly destroy thousands of business relationships involving billions of dollars worth of investments. Whatever the effect on the specific contract between the parties to this case, the Question must be answered in the negative.

[1] The validity of this conclusion by the Court of Appeals is questionable because of the lack of such a fact finding by the District Court.

[2] Presumed to be true, in the absence of any fact finding of coercion.

III.

ARGUMENT

A. The Nature of the Case

The subject matter under consideration consists of rights in discoveries which presumably do not meet the exacting standards of the patent laws, and which, upon being used, are not protected by the trade secret laws of the States, but which nevertheless have value, and for which there is a market.

The particular contract law with which we are concerned is one which would enforce a contract requiring the continued payment of royalties at a reduced rate after the abandonment of a patent application on the discovery which was the subject of the contract, and after the public gained full knowledge of the discovery, such knowledge having been gained from the sales of the product embodying the discovery, and such sales having been the purpose of the contract.

The Question presented is broader, encompassing situations in which no patent application was filed, in which the subject matter was not secret at the time of the contract, and in which there was no reduction in royalty provided for upon abandonment of attempts to patent.

The case at bar is not one in which the contracting parties sought to restrict the right *of the public* to have access to the discovery; on the contrary, the purpose of the contract was to allow a product embodying the discovery to be marketed, and anyone was free to copy the marketed, unpatented product. See *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U.S. 225 (1964), and *Compco Corp.* v. *Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964).

Nor can it be presumed upon the present record that this is a case in which the prospective patent grant was used to coerce, i.e. by a tying arrangement, since there is no finding that rights would not have been granted under the pending patent application except in conjunction with rights to something not covered by the patent application.

This case does not involve any attempted monopolization of any market, nor did any monopoly result from the contract. Rather, extensive competition resulted from the marketing contemplated by the contract.

This is a case in which the parties presumably bargained at arm's length, both being fully aware of the possibility that no patent would issue on the discovery and making provision for that eventuality, and both being fully aware that the necessary disclosure of the discovery to the public in the marketing of the product could, and probably would, result in competitive imitations which, in the absence of a patent, they would be unable to prevent. The licensee was willing to pay under those conditions, and the licensor was willing to accept the agreed-upon payments.

The issue to be decided here is whether the law of the State of Missouri would come into conflict with the operation of the Patent Laws of the United States if that State law were used to enforce the specific terms of the agreement between the parties. In determining this it is necessary to ascertain whether the Missouri law, so applied, would stand as an obstacle to the accomplishment and execution of the objectives of the patent laws, i.e., encouraging invention, and disclosure of innovations for use by the public. *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470 (1974).

Other considerations which may affect some fact situations within the broad scope of the Question presented are:

1) Whether the State law in question would withdraw something from the public domain, creating a monopoly in something which the public had a free right to use;

2) The desirability of maintenance of standards of commercial ethics;

3) Whether a patent right is used in a coercive manner;

4) Whether the patent monopoly is extended beyond the bounds provided by law; and

5) Whether the subject matter sought to be protected by state law is or ever was, in fact, a secret.

The case at bar does not involve all of these considerations. Nothing was withdrawn from the public domain. No monopoly is asserted, and members of the public are free to, and actually do, copy the subject keyholder without any restraint whatsover by Aronson. Aronson asserts only a right to recover the specific amounts contracted for — and only from the party who agreed to pay those amounts. That is the only person who is affected by this agreement.

The maintenance of standards of commercial ethics is at issue in this case. Parties to such agreements as in this case presumably contracted in good faith. A "yes" answer to the Question could affect hundreds, and perhaps many thousands of existing contracts.

The record does not reflect that Aronson used the possibility of a patent grant to coerce Quick Point into signing an agreement which would provide for continued royalty payments after the keyholder design became known to the public.

There is no assertion by Aronson of a monopoly of any kind, and, since no patent ever issued, no attempt to extend control of a patented product beyond the 17 year patent term.

The majority opinion in the Court of Appeals questioned whether the keyholder could be considered a trade secret, but its decision apparently was not dependent upon this. In any event, the subject keyholder was not in the public domain at the time of the agreement. Furthermore, the Question is one of whether there is conflict between the state contract law and the patent law, and the definition of a trade secret under state law is not involved.

B. There is no Conflict with the Patent Laws

This Court concluded in *Goldstein* v. *California*, 412 U.S. 546 (1973), that "the States have not relinquished all power to grant to authors 'the exclusive Right to their respective Writings' " (412 U.S. at 560), and in *Kewanee, supra*, that the States retained some measure of regulatory power over the "Discoveries" which are the subject of Article I, Section 8, Clause 8 of the Constitution.

As the Court stated in *Goldstein*, 412 U.S. at 562:

> "While the area in which Congress *may* act is broad, the enabling provision of Clause 8 does not require that Congress act in regard to all categories of materials which meet the constitutional definitions. Rather, whether any specific category of "Writings" is to be brought within the purview of the federal statutory scheme is left to the discretion of the Congress." (Emphasis by the Court)

We are concerned here with one category of "Discoveries" upon which Congress has not acted. Congress "has left the area unattended, and no reason exists why the State should not be free to act" (412 U.S. at 570).

This Court, in *Kewanee*, determined that Ohio's law of trade secrets is not pre-empted by the patent laws of the United States, holding that the States may exercise regulatory power over discoveries so long as such regulation does not conflict with the operation of the laws in this area passed by Congress (416 U.S. at 324). The Court is now faced with the question of whether the States' laws of contracts by which they may exercise regulatory power over discoveries conflict with the operation of the laws in this area passed by Congress.

As in *Kewanee*, the Court must now consider whether such State laws stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (416 U.S. at 324, quoting from *Hines* v. *Davidowitz, supra*, 312 U.S. at 67), as expressed in the patent laws. These objectives were stated to be the encouragement of innovation, and the disclosure of the innovations to the public (416 U.S. at 325). The Court further reiterated: ". . . that which is in the public domain cannot be removed therefrom by action of the States" (416 U.S. at 325).

The Court concluded in *Kewanee* that the patent policy of encouraging invention is not disturbed by the existence of another incentive to invent, i.e. trade secret law. The Missouri contract law which is questioned in this case is still another incentive to invent, so that in this respect there can be no conflict with the patent law.

The hope of a contract such as that entered into by Aronson and Quick Point is the incentive that encourages untold numbers of individuals to develop their ideas and improvements. A high proportion of manufacturing businesses have procedures established for the purpose of receiving disclosures of such innovations. Normally the businesses protect themselves against claims of misappropriation by suitable agreements with the inventors, and often such businesses will refuse to consider a disclosure unless a patent application is filed. Although only a small percentage of submitted innovations ever becomes the subject of a licensing agreement providing for the payment of royalties to the inventor, the success of a few, like Aronson, fires the enthusiasm of the inventors.

In most cases such licensing agreements are entered into before a final decision by the Patent and Trademark Office on the patentability of the invention, and often before any patent application is filed, so that normally the parties do not know, at the time of negotiating the agreement, whether the invention will ever be patented. Whenever the invention is in a product which is to be marketed, any secrecy which may have existed ends as soon as the product is put on the market. The parties to the agreement recognize, however, that value is received by the disclosure, and that even if no patent is ever granted, the licensee has benefitted from being first on the market with this invention. Such benefit can, and often does, continue even after competitors have copied the invention.

Of course, at the time of negotiating the contract the parties cannot know whether the product will be a success or a failure, or how much competition will result. Thus the value of the invention to the licensee cannot be predicted. The logical, and common, answer is to base compensation to the inventor on success of the invention, by providing a royalty on sales. By this means, the licensor's compensation is commensurate with the benefit received by the licensee. Initial lump sum payments or short-term royalties can seldom accomplish this. Certainly Quick Point would never have agreed in advance to pay Aronson the $200,000.00 plus she eventually received.

It is the anticipation of this kind of royalty which brings the inventors back time after time.

It might be argued that sufficient incentive is provided by providing for royalty only during the pendency of a patent application where no patent results. But many times no patent application is ever filed. Even if an application is filed, a royalty rate set high enough to compensate the inventor and continuing only during the pendency of the application[3] may often be too great a burden on the product.

The encouragement to innovate goes beyond the individual who hopes to reap rewards from his efforts. An important element of income for many businesses is in return for licensing know-how, the specialized knowledge of how to economically and effectively perform a given task. Such know-how is seldom patentable, and often consists entirely of a knowledgeable selection of bits and pieces of known technology, technology which is clearly in the public domain, so that the only "secret" involved is in the identification of the particular parts of known technology which are included.

The existence of the right to contract for the payment of royalties in return for the right to use this unpatented, marginally secret "know-how" has resulted in the growth of large research organizations, a major part of whose effort is devoted to developing just such know-how, with patentable inventions often constituting only a fringe benefit. The enormous fast-food franchising industry in this country utilizes such know-how licensing as a major factor.

Thus it cannot be questioned that contract laws permitting enforcement of agreements such as the one at issue here do provide another form of incentive to invention,

---

[3] Currently patent applications pend in the Patent and Trademark Office an average of 19.8 months.

so that "in this respect the two systems are not and never would be in conflict" (*Kewanee, supra,* 416 U.S. at 327). Maybe Aronson would have sold for a pittance anyway, and maybe some others would also. But many ideas would die aborning, for lack of sufficient incentive. And in the world of sophisticated businessmen, the inventor of a discovery would not likely share his secret with a manufacturer who could not be bound to pay a license fee. The result would be to hoard rather than disseminate knowledge.

Nor is the policy that matter once in the public domain must remain in the public domain incompatible with the enforcement of such contracts. The Question assumes that the subject matter of the contract is, or becomes, in the public domain. The contract in question does nothing to limit the right of the public to use such subject matter; in fact, the publication of the subject matter was the purpose and the result of the contract.

The objective of public disclosure is not hindered in any way by enforcing the contract, for the Question assumes that public disclosure has occurred. Certainly the abolition of this form of State regulation of innovation cannot result in increased disclosure to the public of that which has already been disclosed.

Thus the Missouri contract law in question does not conflict with the purposes and objectives of Congress, as analyzed by this Court in *Kewanee*. On the contrary, it supplements the patent laws, providing additional incentive for innovation in areas not covered by the patent laws, an incentive which is not possible under either the patent laws or trade secret laws, and giving to the public discoveries which otherwise would never see the light of day.

The remarks of this Court in *Kewanee* on the desirability of trade secret laws are equally applicable to the Missouri

contract law in question. The patent laws and contract laws have coexisted in this country since the first patent law was enacted in 1790. "Each has its particular role to play, and the operation of one does not take away from the need for the other" (461 U.S. at 332). This contract law "permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it." (461 U.S. at 332). Until Congress takes affirmative action to the contrary, States should be allowed to continue this form of regulation of discoveries.

C. The State Contract Law is not Barred by Previous Court Decisions

Contrary to the position of the Court of Appeals, the decision in *Brulotte* v. *Thys Co.,* 379 U.S. 29 (1964), does not support its conclusion. Totally different considerations governed the result there. That was a case where the licensor relied upon the statutory patent monopoly, maintaining that monopoly and being compensated for the use of the invention throughout the life of the patent. The patentee there elected, and took advantage of the benefits of, the patent laws, thereby establishing that the subject matter of his licensing agreements was within the area upon which Congress had acted. The Court expressly held that the rule applied there was not applicable to unpatented goods:

> "The sale or lease of *unpatented* machines on long-term payments based on a deferred purchase price or on use would present wholly different considerations" (379 U.S. at 102, emphasis by the Court).

Furthermore, the Court's decision in *Brulotte* was not based on pre-emption at all, but upon misuse, i.e., the illegal extension of the patent monopoly. It was the use of the patent's leverage to project royalty payments beyond the life of the patent which the Court there found analogous to a tying arrangement. In the case at bar, no patent ever existed to provide such leverage.

This Court's decision in *Sears* and *Compco, supra,* also fail to provide support for the conclusion reached by the Court of Appeals. In *Sears* and *Compco,* as in *Kewanee,* the Court looked to see whether there was a conflict between the state unfair competition law and the objectives of the patent laws, and held that such state laws could not be used to create a monopoly beyond that provided by the patent laws, as by providing perpetual protection of an unpatentable design. In both of these cases there was an effort to create a monopoly in the particular designs involved. Here, no monopoly is sought, but only agreed-upon compensation. In *Sears* and *Compco* an effort was being made to prevent use of the designs by others, whereas no such effort exists in the present case, and the design is being made by others.

It was the prohibition of copying by others which the Court struck down. Here there is free copying by others; the only restraint, if a royalty can be called that, is applied to the licensee who agreed to that restraint in return for the head start he received over competition.

The Court of Appeals also sought support in *Lear, Inc.* v. *Adkins,* 395 U.S. 653 (1969). However, the Court there expressly refused to consider "whether, and to what extent, the States may protect the owners of *unpatented* inventions who are willing to disclose their ideas to manufacturers only upon payment of royalties" (395 U.S. at 625, emphasis by the Court.) *Lear* was concerned primarily with the question of whether a patent licensee could be estopped, under State law, to challenge the validity of the licensed patent. The holding was that Lear, who had questioned patentability and stopped paying royalties before the patent was issued, must be permitted to avoid payment of post-patent

issue royalties if Lear could prove patent invalidity. The Lear contract had expressly provided for termination of royalty payments upon a determination of invalidity.

In the case at bar, there is no estoppel question and no contract provision allowing termination of royalty payments on any basis. The *Lear* case does not treat a situation where the agreement was to pay royalties even if no patent ever issued.

The Court of Appeals stated that under the rule announced in *Lear* if Aronson had obtained a patent on her application, and that patent were later determined to be invalid, Quick Point's liability would have terminated "in spite of the contract." Apparently the Court of Appeals' reasoning was that greater benefits should not be obtained by Aronson when no patent was ever obtained. But the benefits are not greater, only different. Under the facts of the case at bar, Aronson received a reduced royalty, on lesser sales, because of competition. If a patent had issued, before the adjudication of invalidity Aronson would have benefitted from the higher royalty and from the increased sales, and quite likely increased price, afforded by the patent protection against competition.

Furthermore, the termination of royalties would not have been "in spite of the contract", where an issued patent was found invalid. Nothing in the contract at issue required payment of royalties after the invalidation of the patent.

There is nothing in *Lear* which mandated pre-emption in this case. As we have noted, the question here was left open in *Lear*.

Thus, the previous decisions by this Court construing the scope of the patent laws do not provide a basis for the decision reached by the Court of Appeals. Such decisions were based on the finding of a conflict with the

objectives of the patent laws or a use of the patent leverage to obtain a degree of control over something not patented. As we have shown, neither situation exists in the case at bar, nor necessarily results from the facts in the Question presented. In fact, State laws which enforce contracts within the scope of the Question provide a further incentive for innovation. Affirmance of the Court of Appeals decision would eliminate this important incentive.

IV.

CONCLUSION

For the reasons stated, the decision of the Court of Appeals should be reversed, and the Question presented should be answered in the negative. The Court's review should be pointed toward the specific facts of this case, and should not affect other fact situations within the broad scope of the Question. In any event, the Court should be careful not to retroactively nullify contracts entered into prior to the Court's decision, thereby providing windfalls to the licensees under such contracts.

Respectfully submitted,

Ned L. Conley
Butler, Binion, Rice, Cook & Knapp
1100 Esperson Building
Houston, Texas 77002

Attorneys for Amicus Curiae, The Patent, Trademark and Copyright Section of the State Bar of Texas

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing Brief was served by mailing, Air Mail, Postage Prepaid, three copies to each of:

Mr. C. Lee Cook, Jr.
Chadwell, Kayser, Ruggles
McGee & Hastings, Ltd.
8500 Sears Tower
233 South Wacker Drive
Chicago, Illinois 60606

Mr. Erwin N. Griswold
Jones, Day, Reavis & Pogue
1100 Connecticut Avenue, N.W.
Washington, D. C. 20036

Mr. Thomas E. Wack
Armstrong, Teasdale, Carmer & Vaughan
Suite 1950
Railway Exchange Building
611 Olive Street
St. Louis, Missouri 63101

on this the .... day of August, 1978.

....